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[illegible] Court of the United States

October Term, 196[illegible]

Bank of Marin, *Petitioner*

vs.

[illegible] H. England, Trustee in Bankruptcy, *Respondent.*

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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Brief for Respondent

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October Term, 1966

No. 63

Bank of Marin, *Petitioner*

vs.

John M. England, Trustee in Bankruptcy, *Respondent*.

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Brief for Respondent

STATEMENT OF THE CASE

Respondent agrees with Petitioner that the facts are not in dispute. Two matters, however, require brief comment.

First, Petitioner has expressed in its Statement of the Case the following erroneous conclusion of law: Petitioner asserts that since the referee held the Bank of Marin and Eureka Fisheries jointly liable to the trustee for the sum of $2,312.82, and since Eureka Fisheries paid said sum to the trustee and served upon the bank a notice of payment and demand for contribution pursuant to California Code of Civil Procedure Section 709, Eureka Fisheries thereby

became entitled "to the remedy of execution to recover from the bank one-half the amount Eureka Fisheries paid on the joint judgment." (Petitioner's Brief, p. 4.) Petitioner implies that the remedy of execution is immediately available to Eureka Fisheries "without the necessity of further proceedings." (Petitioner's Brief, p. 5, footnote 1.) Respondent's view that the law is to the contrary is fully set forth below at pp. 22-23.

Secondly, Respondent is obliged to inform the Court that his pecuniary interest in the final disposition of this case is limited. The judgment of the referee held Petitioner severally liable to Respondent for $700.47, and jointly liable with Eureka Fisheries to Respondent for the further sum of $2,312.82. (R. 48.) Eureka Fisheries did not appeal, and Petitioner did not appeal from the several judgment against it in the sum of $700.47. (R. 50-51.) The only part of the judgment which has not become final, therefore, is the joint judgment for $2,312.82 in favor of Respondent against Petitioner. (R. 50-51.) Meanwhile, Eureka Fisheries has satisfied the joint judgment by payment in full to Respondent. (R. 54-55.) In this posture, Respondent believes he cannot be deprived of any recovery heretofore received and, thus, that Respondent's sole financial interest herein is to protect against the imposition of costs pursuant to the provisions of Rule 57 of the Rules of this Court.

The foregoing is not intended as a retreat from Respondent's legal position that a bank is liable to a trustee in bankruptcy for cashing checks of a bankrupt depositor subsequent to the filing of such depositor's voluntary petition in bankruptcy despite the bank's lack of actual knowledge of the filing of such voluntary petition. Respondent urges that the decision of the Court of Appeals was correct and should be sustained.

SUMMARY OF ARGUMENT

Prior to 1938, the Bankruptcy Act did not clearly define the right of persons dealing, after bankruptcy, with assets of bankrupt estates. Relief was provided, however, under the judicial doctrine of "protected transactions," to persons acting in good faith although the doctrine was imprecise and led to constant litigation.

To resolve the confusion, Congress, in 1938, codified the "protected transaction" doctrine in Section 70d of the Bankruptcy Act. By its terms Section 70d establishes an unequivocal dividing line between protected and unprotected transactions. The conduct of the bank in this case, in honoring, after adjudication, checks drawn on an account that was an asset of a bankrupt estate falls outside the scope of the transactions afforded protection.

Notwithstanding the foregoing, Petitioner claims that it is entitled to protection because the transaction involved the payment of checks. Petitioner relies upon the provision of Section 70d(5) that "nothing in this Act shall impair the negotiability of negotiable instruments," but the negotiability proviso does not apply in this case involving the presentment of checks to a drawee bank for collection.

Petitioner also claims that because the trustee may recover from third parties he should be precluded from asserting his claim against Petitioner. No basis exists for such a restrictive application of Sections 70a and 70d. If Petitioner's view were adopted, the power of the trustee to collect assets of bankrupt estates would be impaired.

The history of the "protected transaction" doctrine and its codification as Section 70d dispels any doubt that Congress acted deliberately and with full consideration of Petitioner's dilemma. This history shows that a real need existed for the adoption of Section 70d and that consider-

able thought was given to the dividing line between protected and unprotected transactions. The rule adopted is a legitimate exercise of legislative discretion, and if the rule is too harsh, Petitioner should direct its criticism to Congress.

The foregoing is especially true in a case such as that now before this Court. Petitioner has paid nothing on the joint judgment. We doubt that Petitioner ever will have to pay as a result of the joint judgment now being reviewed. Even if Petitioner is later required by state court proceedings to contribute to the third party who previously satisfied the joint judgment herein, there is no basis for Petitioner's claim that it would thereby be required to pay the same debt twice. Petitioner made one payment voluntarily under mistake of fact. Petitioner cannot assert its mistaken payment to a third party as a defense to the trustee's claim.

ARGUMENT

I. A Bank Is Accountable to a Trustee in Bankruptcy When It Honors a Depositor's Checks Against Assets of the Bankrupt Estate After the Depositor Has Been Adjudicated a Bankrupt.

The fundamental issue herein is whether Petitioner, the Bank of Marin (sometimes hereinafter referred to as "the bank"), may properly be held liable to Respondent, a trustee in bankruptcy (sometimes hereinafter referred to as "trustee"), for disbursing the bankrupt's post-adjudication deposits resulting from the collection by the bankrupt of pre-adjudication receivables.

The governing statutory rule is that

> "The trustee of the estate of a bankrupt . . . upon his . . . appointment and qualification, shall . . . be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this Act . . . to all . . . (5) property,

including rights of action, which prior to the filing of the petition he could by any means have transferred . . . ." Bankruptcy Act § 70a, 52 Stat. 879 (1938), as amended, 11 U.S.C. § 110(a).

Section 70d of the Bankruptcy Act (52 Stat. 881 (1938), 11 U.S.C. § 110(d)) further provides (in pertinent part) that "no transfer by or in behalf of the bankrupt after the date of bankruptcy shall be valid against the trustee."

The Collier treatise interprets Section 70a as follows:

> "The title of the bankrupt vests in the trustee, 'as of the date he was adjudicated a bankrupt,' but upon thus vesting relates back to the time of the filing of the petition. While it is true that by subsection *a* the trustee, upon his appointment and qualification, becomes vested by operation of law with the title of the bankrupt as of the date he was adjudged a bankrupt, there are other provisions of the statute which evidence the intention to vest in the trustee the title to such property as it was at the time of the filing of the petition, the estate being considered as *in custodia legis* from that time." 4 Collier, Bankruptcy Sec. 70.05, p. 963 (14th Ed. 1964).

Petitioner does not assert that Respondent failed in the performance of any duty imposed upon him by the Bankruptcy Act or otherwise to notify Petitioner simultaneously of the fact of the bankrupt's adjudication. No such duty exists. The attack here unequivocally is made upon the constitutionality of the Bankruptcy Act insofar as it vests solely in the trustee the right to transfer assets of a bankrupt estate immediately upon adjudication and without regard to the good faith of a bank in honoring, after adjudication, checks drawn by the bankrupt against a bank account representing an asset of the bankrupt estate.[1]

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1. Collier comments specifically that "Deposits in a bank to the credit of a bankrupt pass to the trustee as assets of the estate. Thus,

A. UNDER PRESENT STATUTORY RULES, LACK OF NOTICE IS NO DEFENSE TO THE BANK.

Petitioner argues that since it had no notice of the bankruptcy proceedings, its payment of the bankrupt's check upon presentment by Eureka Fisheries fell within the judicial doctrine exempting certain good faith, post-bankruptcy transactions from the trustee's assertion of a prior right under Section 70a of the Bankruptcy Act. (Petitioner's Brief, pp. 19-24.) Petitioner refers to the "protected transaction" doctrine that developed in the cases prior to the adoption of the Bankruptcy Act of 1938. (52 Stat. 840 (1938), 11 U.S.C. § 1 *et seq.*)

As an abstract matter, there is merit in Petitioner's argument that the "protected transaction" doctrine should apply in this case. The fact is that in 1938 Congress codified the "protected transaction" doctrine in Section 70d. As so codified, the doctrine applies only to post-bankruptcy transactions occurring either (1) before adjudication or (2) before a receiver takes possession of the bankrupt's property, which ever first occurs. The doctrine does not apply after adjudication as Petitioner here asserts. The present statutory scheme of "protected transactions" is clear and unequivocal; it leaves no room for the exception urged by Petitioner.

The 1938 codification of the "protected transaction" doctrine also invalidates Petitioner's argument (Petitioner's

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where through delay, a check drawn on such a deposit prior to bankruptcy is presented, and paid after bankruptcy, the payee is not entitled to retain the sum received as against the trustee." 4 Collier, *op. cit. supra,* Sec. 70.31, pp. 1282-3.

We point out also that the deposit here in question was the result of the collection by the bankrupt after bankruptcy of receivables existing at the time of bankrutpcy, and thus no argument has been made, nor could it be, that the deposit in question consisted of after-acquired property of the bankrupt not vesting in the trustee. See 4 Collier, *op. cit. supra,* Sec. 70.09, p. 999.

Brief, p. 23) that pre-1938 "protected transaction" decisions relating to pre-adjudication transactions are currently applicable because of the complementary pre-1938 judicial doctrine that the trustee's title to a bankrupt's assets, although not effective until adjudication, related back to the time a bankruptcy petition was filed.

Notwithstanding the codification of the protected transaction doctrine, Petitioner argues that since adjudication in the case of a voluntary bankruptcy petition became automatic with the 1959 amendment of Section 18f of the Bankruptcy Act (73 Stat. 109 (1959), 11 U.S.C. § 41 (f)), Section 70d no longer applies in voluntary bankruptcy cases, and, therefore, that the pre-1938 case law should be reinstated to provide protection to the bank in the present situation. (Petitioner's Brief, pp. 16-18.)

Nothing in the legislative history of Section 18f supports Petitioner's view. Furthermore, reinstatement of the doctrine in voluntary bankruptcy cases would merely serve to reinstate the confusion that existed prior to 1938 and which Congress attempted to remedy by its adoption of Section 70d.

Petitioner's argument also ignores the fact that the automatic adjudication amendment of 1959 had no necessary relationship to the timing of the adjudication in voluntary cases. Under the pre-1959 statute, adjudication was made on application to the district judge, but the application could be made immediately upon the filing of the voluntary petition. (52 Stat. 851 (1938), as amended. See 1964 Bankruptcy Act, comment to § 18f (Collier Pamphlet Ed.). See also *New York County Nat'l Bank v. Massey,* 192 U.S. 138 (1904).)[2]

2. Even in the case of an involuntary petition, no greater notoriety is given to the fact of adjudication or the appointment of a receiver than occurs when a voluntary petition is filed.

Moreover, nothing on the face of Section 70d indicates that it was intended by Congress to apply exclusively to cases involving involuntary petitions in bankruptcy. The legislative history of Section 70d is directly to the contrary. In his testimony before the House Committee considering the Chandler Bill, Professor James A. McLaughlin, one of the primary draftsmen of the bill, expressly recognized that the question of the trustees' title between the petition and adjudication was a matter of concern in both voluntary and involuntary cases. (Hearings on H.R. 6439, H.R. 8046 Before the House Committee on the Judiciary, 75th Cong., 1st Sess. 210 (1937). See also, Hearings, *op. cit. supra*, pp. 12, 211-12.)

B. THE "NEGOTIABILITY PROVISO" OF BANKRUPTCY ACT SECTION 70d (5) IS NOT APPLICABLE HERE BECAUSE PETITIONER WAS A DRAWEE BANK RATHER THAN A HOLDER OF NEGOTIABLE INSTRUMENTS.

Petitioner here, as did the District Court in *Rosenthal v. Guaranty Bank & Trust Co.*, 139 F. Supp. 730 (W.D. La. 1956), relies heavily upon the proviso contained in Section 70d (5) of the Bankruptcy Act: "That nothing in this Act shall impair the negotiability of currency or negotiable instruments." The court in *Rosenthal* held that because of the "negotiability proviso," a bank was not liable to the trustee when, after the approval of the bankrupt's petition for reorganization (which the court ruled was the equivalent of adjudication for purposes of Section 70d of the Bankruptcy Act (139 F. Supp. at 736)), the bank, in good faith, in the regular course of business, and without actual knowledge of bankruptcy, honored the bankrupt's checks drawn prior to the filing of the petition.

The *Rosenthal* application of the "negotiability" proviso has been severly criticized. For example, Collier comments:

> ". . . a good deal more is read into the proviso of clause (5) by the court in *Rosenthal* . . . than was in-

tended by the draftsmen. . . . [The court's] emphasis on the bank's good faith seems misplaced; good faith is relevant under § 70d (2) but that clause applies only to the transactions anterior to adjudication. . . . To charge a depository bank with liability for cashing checks of its depositor after his adjudication does not impair the negotiability of the checks. Delivery of a check to the drawee bank for payment is not negotiation." 4 Collier, *op. cit. supra,* Sec. 70.68 p. 1502-03 n. 3.

See also Seligson, *Creditors' Rights,* 32 N.Y.U.L. Rev. 708, 729-31 (1957); Note, 64 Harv. L. Rev. 958, 958 (1951).

"Negotiability" is not defined in the Bankruptcy Act. The question is thus one of state law. (See *Erie R.R. v. Tompkins,* 304 U.S. 64 (1938).) Former Section 3111 of the California Civil Code (Cal. Stats. 1917, c. 751, p. 1538 § 1; Repealed January 1, 1965, Cal. Stats. 1963, c. 819, p. 1997, § 2) provided that:

"An instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof. If payable to bearer it is negotiated by delivery; if payable to order it is negotiated by the endorsement of the holder completed by delivery."

The current California statutory definition is contained in Section 3202 (1), California Uniform Commercial Code:

"Negotiation is the transfer of an instrument in such form that the transferee becomes a holder. If the instrument is payable to order it is negotiated by delivery with any necessary indorsement; if payable to bearer it is negotiated by delivery."

The California Supreme Court in *Wells Fargo Bank v. Bank of Italy,* 214 Cal. 156, 4 P.2d 781 (1931), ruled that a drawee bank paying an instrument is not a transferee of title since the last holder's endorsement does not trans-

fer the check but converts it into a voucher and thus that the drawee does not become a holder. More recently, the California District Court of Appeal, in the case of *Shammas v. Boyett,* 114 Cal.App. 2d 139, 249 P.2d 880 (1952), said

> ". . . it would seem fairly obvious that a drawee of a draft or bill of exchange who accepts and pays the same upon presentation does not thereby become a holder in due course of the instrument as that term is employed in the law of negotiable instruments. And the authorities uniformly so declare." [Citing state court decisions from Massachusetts, North Carolina, Ohio, Texas and Tennessee, and a United States District Court decision from the Southern District of Illinois.] 114 Cal.App. 2d at 144.

In view of the foregoing, Petitioner's reliance on *Rosenthal* is not persuasive. Petitioner was not a holder of a negotiable instrument; it was a drawee bank charging the checks of the deposits of its bankrupt depositor. The "negotiability" proviso has no bearing.

C. IT IS NO DEFENSE TO THE BANK THAT THIRD PARTIES MAY SHARE THE BANK'S RESPONSIBILITY FOR THE LOSS OF ASSETS.

Petitioner and the California Bankers Association urge that Respondent should be limited to a recovery from the payee of the checks. (Petitioner's Brief, pp. 25-26; Amicus Brief, pp. 9-12.) At this point, insofar as Respondent is concerned, the question is academic because Respondent already has fully recovered from the payee. The Bankruptcy Act, however, does not require such a rule. The focus of Section 70d (5) is on the transfer of assets of a bankrupt estate. A rule that a trustee may recover only from one benefited by the transfer or presently in possession of the fruits of the transfer would seriously limit the trustee's right of recovery. Such a limitation is conspicuously absent

from the provisions of Section 70. By analogy to common law conversion rules, neither the transferor's innocence nor the fact that he no longer has the property is or should be a defense. (See *Poggi v. Scott,* 167 Cal. 372, 139 Pac. 815 (1914); PROSSER, TORTS § 15, pp. 83, 87-88, 98 (3d ed. 1964).) The trustee ought to be entitled to recover from any transferor or transferee. Any other policy would be inconsistent with the scheme of Section 70 which is to permit the speedy and orderly collection of assets of bankrupt estates.

II. Section 70d of the Bankruptcy Act by Invalidating Post-Adjudication Transfers of Assets of Bankrupt Estates Without Regard to the Transferor's Knowledge of Bankruptcy Does Not Deprive the Transferor of Its Property Without Due Process of Law.

Petitioner asserts that these proceedings have deprived it of its property without due process of law. A review of the cases cited in Petitioner's brief, at pages 11-14, reveals that each deals with an entirely distinct problem from that faced by Petitioner herein. The main concern in Petitioner's authorities was whether adequate notice was given of *litigation* adjudicating the rights of parties to the litigation. (*Schroeder v. New York,* 371 U.S. 208 (1962); *Covey v. Somers,* 351 U.S. 141 (1956); *New York v. New York, N.H. & H.R.R.,* 344 U.S. 293 (1953); *Walker v. Hutchinson,* 352 U.S. 112 (1950); *Mullane v. Central Hanover Bank,* 339 U.S. 306 (1949); *Wuchter v. Pizzutti,* 276 U.S. 13 (1928); *Hanover Nat'l Bank v. Moyses,* 186 U.S. 181 (1902).) In none of the foregoing cases did this Court rule that notice to all concerned was prerequisite to the *creation* of legal rights and obligations; notice was required in each case to assure the parties their opportunity for a day in Court in connection with the judicial determination of rights and liabilities. Petitioner herein has had its day in court.

Moreover, *Hanover Nat'l Bank vs. Moyses*, 186 U. S. 181 (1902) cited in Petitioner's brief, at page 11, indicates quite clearly that actual notice is not required to validate bankruptcy proceedings but only such notice as the nature of the proceeding admits. 186 U. S. at 192. Appellant goes too far in stretching this Court's opinion in *Moyses* (which discussed at length the problems inherent in notifying a bankrupt's creditors) into one standing for the proposition that the rights and obligations of a debtor of the bankrupt (apart from the judicial enforcement of those rights and obligations) as a matter of constitutional law cannot be altered until he is notified of the bankruptcy. As a matter of fact, this Court in *Moyses* expressly rejected the due process argument of appellant therein based on inadequate notice saying:

> "Congress may prescribe any regulations concerning discharge in bankruptcy that are not so grossly unreasonable as to be incompatible with fundamental law, and we cannot find anything in this act on that subject which would justify us in overthrowing its action." 186 U. S. at 192.

Louisville Joint Stock Bank v. Radford, 295 U.S. 555 (1935) cited by Petitioner at page 11, involved a legislative attempt to vest insolvent farmers with the right to use the property of others without compensation. No such problem is presented herein because the only assets involved under Section 70d are those belonging to bankrupt estates.

Two of Petitioner's cases, both decided before 1938, simply applied the protected transaction doctrine more broadly than now permitted under Section 70d. (*Frederick v. Fidelity Mut. L. Ins. Co.,* 256 U.S. 395 (1921); *Jones v. Springer,* 226 U.S. 148 (1912).)

Lambert v. California, 355 U.S. 225 (1957) cited in Petitioner's brief, at pages 12-13, is distinguishable because the statute there held unconstitutional on due process grounds, imposed criminal liability not for an affirmative act, but for the failure of a convicted felon to register when the registrant did not know of the registration requirement, and the state had not proved the probability of such knowledge. The Bankruptcy Act creates an obvious risk for the bank quite different from the risk faced by Mr. Lambert. The bank assumed the risk posed by Section 70d.

While Congress cannot ride roughshod over the property rights of those dealing in good faith with bankrupts, Congress certainly may enact legislation balancing conflicting legislative objectives. The history of the development of Section 70d demonstrates that Congress carefully balanced the property rights of those dealing in good faith with bankrupts against the desirability of speedy and orderly administration of bankrupt estates. As evidence thereof, Respondent respectfully refers the Court to the excellent historical analysis contained in 4 Collier, *op. cit., supra,* Sections 70.66 and 70.67, pp. 1494.26-1501, inclusive:

> "Prior to the enactment of § 70d as a part of the 1938 Act, there was no statutory law with respect to protected transactions in bankruptcy. Judge-made law, compelled by considerations of justice and equity, frequently moved to protect those whose bona fides in dealing with the bankrupt after bankruptcy were clear. But, as demonstrated hereafter, the situation was fraught with an uncertainty which might have delighted a disciple of the functionalist school of legal philosophy, but which held only the Damocles sword of possible economic loss suspended over those engaged in ordinary commercial pursuits. *The Act of 1938 brought an end to this, and the definitive standards of*

§70d supplanted the nebulous vagaries of the prior law. The statutory innovation thus introduced was largely the result of the impetus furnished by one man —Professor James A. McLaughlin of Harvard University, whose article in the Harvard Law Review in 1927 urged some provision for protected transactions along the lines of the English Act. As there stated by Professor McLaughlin and later repeated by him in the *Analysis of H.R. 12889,* the situation was "conducive to confusion and uncertainty, with potentialities for argument, 'bluffing', litigation, expense and delay.'

* * *

"As previously stated in the treatise, the courts prior to 1938 were faced with two contradictory concepts. On the one hand, despite the inconsistent language of § 70a and the lack of definite statement in other provisions of the Act, the filing of the petition was held to be a *caveat* to the whole world, and in effect an attachment and injunction. This proposition was an essential prop to the bankruptcy court's assertion of jurisdiction and power in preventing the dissipation and attachment of the assets of the estate, in determining the rights of claimants under the various provisions of the Act, in fixing the right of set-off against the estate, in enjoining non-bankruptcy proceedings that interfered with the bankruptcy administration, and generally in adjudicating the very nature and extent of the bankruptcy court's exclusive control. On the other hand, the courts were often impelled to make exceptions to the doctrine where its application would work a hardship on an innocent party who, following the inception of bankruptcy, dealt with the bankrupt on a bona fide basis for a present consideration. The concept that the filing of the petition was a sort of *lis pendens* was probably justifiable and proper in the instances just previously enumerated, but where innocent parties were concerned, it was recognized that as a practical matter the mere filing of the petition gave rise to no

actual notice that would put such persons on guard. *These propositions, of course were inherently inconsistent, and whether the one or the other would prevail in a close case was always a matter of conjecture.* Nor was the confusion improved by the gradual and parallel evolvement of the 'relation back' doctrine, which served to rationalize the introductory portion of § 70a with the provisions of § 70a(5) and fixed the date of filing the petition as the date of cleavage with respect to the trustee's title. As a matter of fact, the former statement in the introductory portion of § 70a that appeared to fix the trustee's title as of the date of adjudication was seized upon by some courts to justify the protection of a particular transaction, even though in other situations the time of filing came to be regarded as the determinative date.

"From this development, however, certain instances could be singled out where it was possible to predict that the transaction, even if effected after bankruptcy, would be protected from invalidation. Thus it was held that an alleged bankrupt, acting in good faith, was entitled to conduct his business, enter into legitimate contracts in connection therewith and utilize his funds in paying the expenses of operation prior to his adjudication or until such time as a custodian or receiver was appointed to take charge of the estate. Payments of funds of the bankrupt, without notice of bankruptcy and in the usual course of business—as by a bank or an insurance company—, were also protected *prior to* adjudication or the appointment of some officer to have preliminary custody or possession of the estate. Of course, if the transaction were actually fraudulent or amounted to a preference of a creditor, whether the creditor was innocent or not, it could not be sustained. *And it was undisputed that after an adjudication, in bankruptcy, all transfers of the bankrupt's property both by or to innocent parties were nonetheless invalid.* It was said that an adjudication was notice to all the world.

"Yet despite these instances, there remained considerable uncertainty as to how far and when the theory of protected transactions could be implemented. The courts themselves were cautious and somewhat doubtful in their language, and as Professor McLaughlin so aptly pointed out, the situation was fraught with undesirable possibilities that demanded correction. . . .

"It was admitted by the proponents of § 70d that its enactment as a part of the 1938 Act would not tend to increase subsequent dividends to creditors of bankrupt estates. But, as pointed out by Professor McLaughlin, it was possible to go too far the other way in cutting off all rights or claims as of the date of bankruptcy. Despite the temptation to use a picturesque metaphor, the courts prior to 1938 had been prone to conclude that for some purposes, at least, one who was petitioned against was neither civilly nor economically dead. Section 70d recognizes this practical viewpoint and has the added virtue of defining . . . the exact limits under which certain specified transactions will be protected. *Beyond those limits the courts are no longer free to go.*

"The theory of protected transactions as enunciated by § 70d creates, of course, an exception to the general rule, now firmly fixed by the Act, that the time of filing the petition is the date of cleavage in bankruptcy. Thus the operation of the mere filing of the petition as a *caveat* must give way to this statutory qualification. The draftsmen of the 1938 Act were consistent, however, in their regard for protected transactions. The contemporaneous adoption of § 63b has made possible the filing of claims by those who contract on a bona fide basis with an involuntary bankrupt before adjudication or the appointment of a receiver.

"But it must be kept in mind that §70d . . . defines the full extent to which bona fide transactions with the bankrupt, after bankruptcy, will be protected. Subject to the exceptions thus created, the bankruptcy petition

is still a caveat and persons dealing with the bankrupt thereafter do so at their own peril. (Emphasis supplied; footnotes omitted.)

In his 1937 testimony before the Chandler Committee, Professor McLaughlin analyzed the reasons for the adoption of Section 70d as follows:

> "The trustee's title is in an unsatisfactory state . . . with reference to the time when it accrues. The Act of 1898 states that he gets title as of the adjudication, but makes no express provision for the general protection of the bankrupt estate in the interim between the petition and the adjudication. This gap has necessarily been supplied by the courts, but in an unsystematic manner, which at times seems almost disingenous. The Supreme Court in *Mueller v. Nugent* declared that 'a petition in bankruptcy is a *caveat* to all the world, and in effect an attachment and injunction.' This statement may seem on its face to be a potent source of litigation. Any suspicion to this effect is not diminished by the fact that it has been cited over thirty times by the Supreme Court and more than three hundred times by the lower federal courts. Few, if any, bankruptcy cases have been cited as frequently, and indeed there cannot be many Twentieth Century cases in any field which have been more frequently so noticed. The above quoted *dictum* has been the life of the entire party. It has been entertained in almost every conceivable way, being applied according to its face value or distinguished as convenience or common sense dictates. Mr. Justice Holmes said the statement 'must be taken with reference to the facts before the court and not as applicable to all intents and purposes.' He cited with approval a passage where Sanborn, J., referred to 'later decisions of the Supreme Court adjudging that this statement applies only to parties who have no substantial claim of a lien upon or a title to the property of the bankrupt, and that,

against those who have such claims . . . . when the petition . . . . is filed, ... its filing is neither a *caveat* or an attachment and that it creates no lien. . . . .' Circuit Judge Ward, upholding a decision in favor of a bank honoring a check of the bankrupt between the petition and the adjudication, said, 'whatever else the remark may mean, it cannot mean, in contradiction to the express provision of the Act, that the title of the bankrupt shall vest in the trustee as of the time of filing of the petition.' However, even this apparently safe statement is far from the truth, for it is stated that 'broadly speaking the adjudication when made relates back to the commencement of bankruptcy proceedings.' The fact is that the theory of a date of cleavage as of which the assets and liabilities of the estate are adjusted is almost indispensable to the conduct of bankruptcy administration. The Bankruptcy Act of 1898 is clearly constructed with primary reference to the filing of the petition as the date of cleavage. As we have seen, the failure to prohibit transactions detrimental to the estate after the petition suggests the assumption that the property is *in custodia legis,* at least 'for certain purposes,' after the petition. Furthermore, claims are made provable or not depending upon their existence in some form at the date of the petition. Apart from unimportant exceptions proposed by the Chandler Bill the bankrupt has unqualified title to the property he acquires after the date of the petition. Upon the whole, it seems fair to say that, whatever this much discussed *dictum* may mean, the Bankruptcy Act of 1898 really means precisely that 'the title of the bankrupt shall vest in the trustee at the time of the petition,' 'in contradiction to the express provision' found in one clause of the Act.

"The only trouble with this theory is that it discloses a very serious gap in the Act of 1898 in that there is no reference to transactions to be protected after

the date of the petition. The simplest solution is to give the trustee title from the petition and expressly provide for the type of subsequent transactions to be protected. The Chandler Bill endeavors to give the courts such a clear statutory basis (in lieu of a crazy quilt of contradictory judicial statements) with which to continue to work out a reasonable system for balancing the conflicting interests during the term between the commencement of the proceedings and the commencement of the actual administration when the receiver or trustee moves to reduce the assets to his possession." Hearings on H.R. 6439, H.R. 8046 Before the House Committee on the Judiciary, 75th Cong., 1st Sess. 211-12 (1937).[3]

The foregoing historical record has been given judicial recognition in the Fourth Circuit decision of *Lake v. New York Life Ins. Co.*, 218 F.2d 394 (1954), where the Court of Appeals concludes, after reviewing the factors discussed above:

"It is obvious that the intent of . . . [Section 70d] . . . is to invalidate transactions not granted specific protection under the Act and thus put to an end the confusion theretofore existing in the decisions. There is almost always some injustice or hardship which attends transactions occurring after the filing of a petition in bankruptcy between the bankrupt, acting wrongfully, and an innocent third person, because the loss must fall either upon the third person or upon the creditors of the bankrupt. Whether the line which has been drawn is the best possible solution of the problem is not for the courts to say. The line has in fact been drawn by competent authority and it is no longer

3. Professor McLaughlin was reading from his article "Aspects of the Chandler Bill to Amend the Bankruptcy Act," published in the University of Chicago Law Review shortly before his appearance before the Chandler Committee. 4 U. Chi. L. Rev. 369, 381-83 (1937).

> necessary for the courts to make the attempt, which has not been conspicuously successful in the past, to decide cases on the facts as they arise and to draw a fine distinction between transactions which should be protected and those which should not. . . ." (218 F.2d at 399.)

A great deal has been said in Petitioner's brief about the injustice of a rule that a bank is not protected on payments made by it of funds belonging to the bankrupt's estate subsequent to the filing of a voluntary petition in bankruptcy where the bank has no actual notice of the bankruptcy.

Any bank must certainly be charged with knowledge of the possibility of bankruptcy of any of its depositors. Some protection to the bank would be offered in the daily scanning of legal publications containing notices of local adjudications. We believe Petitioner exaggerates when it says "To be fully protected the bank would have to keep itself advised momentarily of every bankruptcy filing in every district in the country." (Petitioner's Brief, p. 14.) Common experience indicates that depositors tend to bank near their commercial activity. Bankruptcy petitions normally will be filed in the district in which a depositor resides or has his principal place of business. (Bankruptcy Act § 2a (1), 52 Stat. 842 (1938), 11 U.S.C. § 11(a).)

The impact upon banks of the rule urged by Respondent is likely to be reduced further by the likelihood that, exactly as happened here, the payee of the check will pay the trustee, and even if the bank pays initially it would have a cause of action against the payee since the bank paid under mistake of fact and the payee was unjustly enriched. See RESTATEMENT, RESTITUTION, §§ 9, 16, 23 (1937); *National Bank of California v. Miner,* 167 Cal. 532, 140 Pac.

27 (1914); *American Oil Service v. Hope Oil Co.,* 233 Cal. App. 2d 822, 830-31, 44 Cal. Rptr. 60, 65-66 (1965); *Burckard v. Smith,* 80 Cal. App. 104 (1926).

On the other hand, Congress was fully conscious of the timing problem faced by trustees. Normally there is an interval between the filing of a voluntary bankruptcy petition and appointment and qualification of a trustee or receiver, and there necessarily is a second gap before the trustee or receiver can notify the bankrupt's debtors of the appointment. Here the interval between appointment of the receiver and the mailing of notice to the bank was two days (R. 1, 44, 45-46), not an unreasonable time when it is remembered that the bankrupt's balance at the bank at the time of adjudication was a nominal $195.54. (R. 7.) The interval will vary depending upon the accuracy and completeness of the information given by the debtor as well as the trustee's ability to find the debtor and the debtor's proximity.

Regardless, Congress did not provide in Section 70a that the trustee shall be vested with title upon giving notice of bankruptcy to those in possession of assets of the bankrupt estate. Congress provided that title shall vest in the trustee "by operation of law . . . as of the date of the filing of a petition in bankruptcy." The solution achieved in Section 70d is not arbitrary. Since the statutory solution reasonably serves conflicting goals, the statute does not infringe constitutional rights of due process. *Hanover Nat'l Bank v. Moyses,* 186 U. S. 181 (1902). As one writer commented:

> ". . . much of the usual routine of due process may be clipped short where due and speedy administration of the affairs of an insolvent is the objective and a liquidation and settlement of his affairs is of paramount

practical importance." 1 Remington, Bankruptcy, Section 11, p. 23 (1950).

If the rule is too harsh, Petitioner should direct its criticism to Congress.

III. The Decision of the Court of Appeals Does Not Require Petitioner to Pay the Same Debt Twice.

A. PETITIONER'S CLAIM THAT IT WILL BE REQUIRED TO PAY TWICE IS OBVIOUSLY SPECULATIVE.

Petitioner's claim that it may be required to pay twice is based upon the reasoning that since the referee held Petitioner and Eureka Fisheries jointly liable to Respondent for the sum of $2,312.82, and since Eureka Fisheries paid said sum to Respondent and demanded contribution from Petitioner, Eureka Fisheries thereby became entitled "to the remedy of execution to recover from the bank one-half the amount Eureka Fisheries paid on the joint judgment." (Petitioner's Brief, p. 4.) Petitioner implies that the remedy of execution is immediately available to Eureka Fisheries "without the necessity of further proceedings." (Petitioner's Brief, p. 5, footnote 1.)

Whether the remedy of execution is immediately available to Eureka Fisheries was the subject of supplemental briefs requested by the Court of Appeals below (R. 104), and in its opinion the Court of Appeals expressly reserved opinion as to whether Petitioner will have to pay any part of the obligation satisfied by Eureka Fisheries. (R. 116, footnote 12.)

Under California law, a claim for contribution is not enforceable by writ of execution as Petitioner contends, but rather must be enforced (1) by separate legal action or (2) upon noticed motion in the same action. (See, for example, *Backer v. Grummett*, 39 Cal. App. 101, 178 Pac.

312 (1918); *Stowers v. Fletcher,* 84 Cal. App. 2d Supp. 845, 848 (1948).

If and when Eureka Fisheries asserts its contribution claim the bank may raise the defense that in paying the trustee pursuant to the joint judgment, Eureka Fisheries merely was disgorging a payment by which it had been unjustly enriched, and which was made to it by the bank under mistake of fact. (*Cf.* cases cited at pages 20-21 above.)

B. THE COURT OF APPEALS' DECISION DOES NOT HOLD PETITIONER RESPONSIBLE FOR A DEBT THAT HAS BEEN PAID HERETOFORE.

Although the lower courts held Petitioner jointly accountable with Eureka Fisheries to Respondent trustee in bankruptcy for assets of the bankrupt estate (R. 48, 99-100) and although the Court of Appeals sustained that judgment over Petitioner's objection (R. 105-116), no decision herein requires Petitioner to pay both the trustee and Eureka Fisheries. Petitioner's payment to Eureka Fisheries was made voluntarily and not in satisfaction of a legal obligation, but under a mistake of fact. The legal relationship of the parties changed by operation of law at the moment the bankruptcy petition was filed. Thereafter, although the bank remained under the mistaken impression that it was obligated to pay as directed by its bankrupt depositor, it had no obligation to pay. The bank's only obligation was to pay the trustee, and payment to a third party violated the express mandate of Section 70 of the Bankruptcy Act.

Brief comment is necessary at this point concerning the argument of the California Bankers Association (Amicus Brief, pp. 3-8) that the bank's contractual obligation to pay Eureka Fisheries could be terminated only by timely stop payment notice from Respondent. The argument is based

upon the erroneous assumption that at the time the bankrupt's orders for payment were delivered to the bank the bankrupt still had the right to order payment against its account. Section 70a is clear that the bankrupt's right to order payment against its account terminated on the date the bankruptcy petition was filed, in this case six days before the bank received the bankrupt's checks. (R. 44, 46.)

C. EUREKA FISHERIES' CONTRIBUTION CLAIM IS INDEPENDENT OF THE TRUSTEE'S CLAIM AGAINST THE BANK AND, THEREFORE, NO PROBLEM OF OVERLAPPING JURISDICTION EXISTS.

The question of Eureka Fisheries' alleged right to contribution has no bearing on the bankruptcy question, for it is recognized under California law that the right to contribution constitutes a new and distinct obligation in favor of one satisfying a joint judgment. (See, for example, *Pacific Freight Lines v. Pioneer Express Co.,* 39 Cal.App 2d 609, 103 P.2d 1056 (1940).

Section 2 of the Bankruptcy Act (52 Stat. 842 (1938), as amended, 11 U.S.C. § 11) demonstrates on its face a Congressional intent to limit the jurisdiction of bankruptcy courts to issues necessary to the preservation and collection of bankrupt estates. Nothing therein suggests a broad jurisdictional grant to determine collateral disputes having no effect on the assets of bankrupt estates. (See, for example, subsections 2a(2), 2a(3), 2a(5), 2a(15).)[4]

Because the contribution claim is independent, Petitioner's problem of potential liability to Eureka Fisheries

4. Respondent notes also that, apart from bankruptcy, Eureka Fisheries' contribution claim presents no issue cognizable in federal court for the reason that there has been no showing that the parties to the dispute are of diverse citizenship (28 U.S.C. § 1332); the claim presents no controversy arising under the Constitution, laws or treaties of the United States (28 U.S.C. § 1331); and the amount of the claim, that is $2,312.82, is below the jurisdictional minimum of federal courts (28 U.S.C. §§ 1331, 1332).

is quite different from the problems considered by this Court in the cases cited in Petitioner's Brief at page 15.

In *Western Union v. Pennsylvania,* 368 U. S. 71 (1961), this Court was faced with conflicting claims to a single fund by several states. No single state court could effectively adjudicate a claim asserted by a sister state. The problem was the practical one of finding a forum with jurisdiction that extended throughout all states concerned, and such a forum was found in the United States Supreme Court. In our case, the comparable forum for the resolution of claims to the assets of bankrupt estates is found in bankruptcy proceedings and the resolution of the contribution claim is unnecessary to the resolution of the bankruptcy proceedings.

Harris vs. Balk, 198 U. S. 215 (1905), also dealt with the problem of conflicting jurisdiction and the possibility that payment of an obligation in one forum would not effectively protect an obligor from re-assertion of the obligation in a second forum. Petitioner here has made no showing that it might have been held liable to either its depositor or the payee on the depositor's check had it refused to honor a check drawn on the account of its bankrupt depositor.

Huron Holding Corp. v. Lincoln Mine Operating Co., 312 U. S. 183 (1941), is also distinguishable. This Court was there concerned with the assertion of a single obligation in both state and federal court proceedings.

For the foregoing reasons, Respondent believes that there is no basis for Petitioner's claim that it has been or will be required to pay the same debt twice or that the judgment infringes constitutional standards defined in *Western Union, Harris, or Huron Holding Corp.*

CONCLUSION

For the foregoing reasons, Respondent respectfully submits that the judgment of the Court of Appeals for the Ninth Circuit should be affirmed.

Respectfully submitted,

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